Marine/Offshore Outlook 1986

Marine Business

Compiled by
Dewayne Hollin
Marine Business Management Specialist

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MARINE OFFSHORE OUTLOOK

1986

Compiled by

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The Marine/Offshore Industry Outlook Conference is an annual event sponsored by the Texas A&M University Sea Grant College Program and the Marine Services Association of Texas. Its purpose is to bring industry representatives up to date on developments, trends and problems in marine and offshore industries.

This summary, compiled by Dewayne Hollin, was prepared from speakers' remarks at the 1986 conference in Houston, Texas.

For further information about other conferences and seminars sponsored by Sea Grant for marine-related industries, contact Dewayne Hollin, Sea Grant College Program, Texas A&M University, College Station, Texas 77843-4115; phone 409/845-3854.

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"An Overview of Energy Industry Developments as They Relate to the Offshore Oil and Gas Exploration and Production Industry"

DR. WILLIAM L. LEFFLER, Shell Oil Company

Many observers thought the price of oil was going to continue forever at about $10 a barrel, and that oil and gas would continue to replace coal in our economy. In 1973 we got educated because the oil price rose rapidly causing everybody to say "oil is too much in demand and available suppliers are uncertain." Having a cartel also made forecasting oil prices easier. The higher price allowed nuclear energy and coal to come back into the picture to help moderate the demand increases for oil. We got even smarter in 1979 when we almost got the forecast right but failed to take into account the fact that the cartel also had a hold on the industry.

What we really need to do is bring all of the technologies into the picture that will moderate the demand for oil, because future oil is really going to be in short supply. We also need to find ways to convert coal and shale oil into oil and gas and to develop all of the exotic energy technologies like solar and wind. We also have to develop new technologies for conservation, to be supported by the ever growing increase in oil price, which should be in the $60 to $70 a barrel range in the not too distant future. The most robust of all of these technologies turned out to be conservation, which coupled the substitution of coal and nuclear power in the world helped reduce the demand for oil.

The tremendous response of conventional oil and gas exploration and production turned the oil market soft in 1981 and sour in 1982, 83, 84, and 85. These three things really created a soft oil market: (1) a tremendous response by consumers in conservation; (2) the ability of consumers to switch to other kinds of energy; and (3) the capability of the exploration and production industry to generate significantly more oil and gas than was expected. The question now is how are we going to get back into the regime that we were in during the 60's when oil was cheap enough to replace coal creating more oil demand. Will prices go up again? Or will they stay the same, so that oil is expensive enough to create a choice between oil and coal with some sort of trade offs?

If you are trying to figure out what is going to happen this year and over the next few years, you will find there are at least five theories to consider for 1986.

The first theory is for wishful thinkers. This theory supports the idea that the Saudis are making a show of strength to discipline the OPEC cartel. The Saudis have always been the swing producer who wrestles with the other 12 members of the OPEC cartel who have all been cheating by selling more oil on the market. This is to the detriment of Saudi Arabia who, as the swing producer, has to absorb all loss. As a result of cutbacks, Saudi Arabia ended up exporting less oil last summer than the United Kingdom.

Last fall they increased their crude oil production from 2.5 million barrels to 4.5 million barrels a day, and within a couple of months the price dropped by 50 percent to the present low teens. Now that they are producing 4.5 million barrels a day and exporting about three million barrels a day, they have shown their market power. They could withdraw that market power now that they have demonstrated to the other OPEC Cartel members and other oil exporters that they are really in charge. If that is their motive then by the end of this year the price could get back up into the twenties. When most forecasters talk about this theory they get vague about what happens in 1987, but the price line around the twenties is the level the Saudis would like and the rest of the OPEC Cartel would be very satisfied with.

Another theory is that the Saudis did what they did out of frustation; they were so desparate financially that they had to increase their production volume. They decided to go for volume instead of price and not worry about the rest of the cartel, but in the process they really got surprised because the price dropped significantly more than their export increased. If the Saudi's have lost control, then the marginal production costs of oil around the world sets the price. Nobody knows exactly what the marginal production cost around the world is, but in Saudi Arabia it is probably a $1.50 per barrel. Marginal production cost around the world is probably less than $10 per barrel.

Another theory, "The Village Mentality Theory," is the way Mexico or maybe most of the other OPEC nations might think about it. That is, this price drop is all a conspiracy, and the Saudis and the U.S. got together to lower prices to solve each other's problems. The Saudis were losing political and economic prestige. So the price drop demonstrates that they have the economic power and the respect of the other OPEC members. The U.S. solves two big economic problems, the budget deficit and the trade deficit, at the same time with lower oil prices. If that is in fact what has happened then today's prices are what the big consumer and the big producer would like.

Theory number four is the favorite of the most quoted energy guru, Dale Steffes, who has been saying for the last five years that long term equilibrium price is really about $15 to $20 a barrel when you consider basic supply demand balance, because cartels do not last. Fifteen or $20 a barrel oil gives moderate demand growth, the kind that can be accomodated without any difficulty; adequate ENP incentives; sufficient supply, and competition from coal. It could be a very pleasant world with $15 to $20 a barrel oil, as long as you are not in it.

The last theory is the one the Wall Street traders would like, particularly the traders that hang around the New York Mercantile Exchange. Theory number five is that oil is just another commodity. No one is in charge, except the marketplace. Oil is a lot like sugar, cocoa, copper, coffee and orange juice, and world events cause the price to go either up or down. If there is a freeze in Brazil or a war in Libya, the price goes up, and when it is over the price goes down.

What we see is the price going way down in the latter part of the 8Ø's. World exploration and production gets cut back. Supplies go way down. Everybody enjoys low price gasoline and drives more. Then demand and price go way up, as in 1972. Some where in the 9Ø's we may get a big price spike again. It is very difficult to pick the right theory, and everyone would like me to pick one so they would know Shell's best guess on what is going to happen to the price over the next four or five years. My answer to that is the Gypsy proverb, "He who lives by the crystal ball soon learns to eat ground glass."

"How Energy Industry Developments Impact on Specific Segments of the Marine/Offshore Industry"

Panelists:
GARY WEATHERS, Hughes Offshore
LEON C. HERON, JR., Gulf Marine Fabricators, Inc.
WILLIAM C. HIGHTOWER, Tidewater Marine Service, Inc.
GARY L. KOTT, Global Marine Drilling Co.
J. WESLEY ROGERS, Oceaneering International, Inc.

PRODUCTION EQUIPMENT MANUFACTURERS

GARY WEATHERS, Hughes Offshore

Today, the world again finds the petroleum industry in a state of turmoil and indecision. But today's state of affairs is much different than the crisis that faced us a few years ago. Now, even those who can stabilize the market are suffering economic hardship. How long will it last and what will happen to stabilize the industry, of course, we can't speak with certainty. But those of us who work in the industry must try to anticipate what will happen in our segment of the market.

In trying to anticipate what the outcome will be we must evaluate at least 3 important factors that influence this market: uncertainties in governmental action; geopolitical response to the market; and the development of technology.

Uncertainties about policies that producing countries will pursue, and further uncertainties about their ability to follow any given policy add risk to the economics of drilling and production. The result has already been seen: abandonment of many marginal land and offhshore wells, cancellation of near-term subsea development plans, deferment of long term subsea development plans, and a marked decline in offshore drilling.

By "Geopolitical Response" we are referring to the different ways we expect different regions of the world to respond to changes in the market. Certain areas will be protected or even subsidized by their government's policies. Others will see special hardships caused by taxation or other negative effects of governmental action.

Worldwide, this is what we see in the short term. Development of U.S. and Canadian subsea reserves will slow even further. We have already seen the impact of this in the job market. During the next year we will see other effects of the crude oil price war. Many land-based oil wells being shut in today are not recoverable. That is, they cannot be brought back on stream. The result: the loss of thousands of barrels per day in U.S. production and the loss of millions of barrels of U.S. reserves.

In the United Kingdom sector of the North Sea, we see that most ongoing projects will be deferred despite govenment support. We believe Norway will slow or defer its development projects, but governmental support will be strong, keeping up certain levels of work in Norway's sector of the North Sea. The Asia-Pacific area is uncertain, with possible deferment of planned projects. Brazil will continue on its program to attain self-sufficiency in oil. Similarly, India's government will also continue programs currently planned. Overall, we believe the smaller development projects will be cancelled due to econooic considerations, and major developments will be extended.

Major producers remain active in exploration programs, and although substantially smaller than anticipated a few months ago, these programs still account for billion-dollar budgets in the near term. In addition, the possibility exists that new operators will enter the offshore arena because costs are so low, as indicated by one company quoted in a recent edition of the Ocean Oil Weekly Report.

The third influence on the industry is Technology Development. This factor will have a substantial impact on the longer term outlook. The large reservoirs will eventually lead development back into the deeper waters. As deep water projects are evaluated, improved drilling and production equipment will be needed such as floating production systems and new types of platform systems. More cost-effective solutions will be required in the entire range of drilling and production equipment. Hughes is currently working on several significant projects that are examples of this technology. These systems offer more cost effective solutions to drilling, testing and production in deep water. This technology, we hope, will strategically position our company for the future.

In brief, although short term development activities continue, our market will decline due to current reduced activity in exploration and production. And as prudent managers, we must continue to size our operations to match our market. In the long term the continuing need for offshore oil and gas will provide a healthy market for our products and services. World energy requirements will continue to grow, and in future years the offshore basins will supply an increasingly larger percentage of this energy.

Because in the near term there will be fewer projects, and because many of these projects will require suppliers to invest in developing new, cost-effective technology, we expect the market forces to cause further consolidation of suppliers. The result could well be that no more than three companies will emerge as viable suppliers of high technology, subsea drilling and production systems in the near future.

FABRICATION INDUSTRY

LEON C. HERON, JR., Gulf Marine Fabricators, Inc.

SHORT-TERM

As a result of the falling oil prices, many projects scheduled for fabrication have either been delayed, postponed or cancelled. The result is that the majority of the fabrication yards along the Gulf Coast have little, if any, contracts booked into 1987.

Because of the limited number of projects that are available to bid, the pricing on the available work has become catastrophically low as fabricators try to cover their fixed costs for the year. This trend has been evident for well over a year, and the results have taken their toll with the like of Raymond, Service Machine and others closing their facilities.

Sensible competition is healthy and is the foundation of our free enterprise system, but the levels to which we in the fabrication industry have been drawn is nothing short of insanity, and in my opinion is close to suicidal.

I think we would all agree that showing a profit is what each of us in responsible management positions are charged with. Unfortunately, minimizing losses is not the same as posting a profit.

A secondary result of declining work is the gradual loss of skilled labor, and in some cases the reduction in hourly wages paid. This is resulting in a large number of skilled workers moving out of the Gulf Coast area and/or making a career change.

The impact on the fabrication industry is a lack of skilled workers and an increased number of inexperienced workers who require extensive training. This results in lower productivity and higher costs, which includes the added training costs. It has always been the industry's practice to provide training to upgrade individuals' skills to supplement the first line skilled workers, but now we are faced with training of the first line workers.

I realize that I have painted a pretty dismal picture, and I also have been extremely critical of how we as an industry have reacted to this depressed market, but I strongly feel that we must evaluate our policies and strategies to return to a more sensible market place.

INDUSTRY TRENDS TOWARD DEEPWATER

According to the Department of the Interior, Minerals Management Service, the Gulf of Mexico holds the lions share of as yet unleased, undiscovered oil and gas resources in U.S. Waters. There is a present surge in deep water activity due to several factors. Primarily, deepwater Gulf of Mexico oil and gas reserves discovered in the late 1970's have been developed and proven their economic success; i.e., Shell's Cognac (1,025 FT), Exxon's Lena Tower (1,000 FT), Arco's Platform A, Union's Cerveza (940 FT) and Cerveza Ligera (935 FT), Zapata's Tequilla (658 FT).

In addition, the Department of Interior's area-wide leasing sale concept has provided record available exploration acreage. Thus operators can pursue a broad scope of geological ideas; the result, an exploratory drilling boom in deep Gulf of Mexico waters.

DEEPWATER PRODUCTION TECHNOLOGY

A major area of deepwater activity is the Green Canyon area of the Gulf of Mexico, approximately 150 miles southwest of New Orleans. Current industry plans incorporate at least 12 major deepwater production projects for Gulf of Mexico installation between 1986 and 1988. Shell, Conoco, Exxon, Mobil, Texaco, and Placid are all currently designing deepwater production structures to service this new frontier.

With the amount of money that oil companies have invested in deepwater leases, it is a foregone conclusion that a substantial number of deepwater platforms will be constructed. The first of the new generation platforms is Shell's Bullwinkle. Shell's Bullwinkle Platform is to be installed in 1,350 feet of water in the Green Canyon. The jacket will weigh 50,000 tons and require approximately 110 acres of fabrication space as well as a special launch barge and a 40 foot deep basin for loadout. Industry officials claim that 1,050 foot launch barge could feasibly and technically handle structures for water depths of 1,600 feet.

Bullwinkle is being fabricated as a 1,365 foot long "fixed" platform. The big question is "What is the water depth limit for conventional platforms?" Many people believe the magic number is 1,500 feet. With half of the 1984 leases in water depths greater than 1,500 feet many designers feel the future lies in compliant structures (a slender structure whose base is rigidly fixed to the sea bottom and acts like a flexible column; able to withstand large displacements under severe conditions). Floating production facilities are another alternative under consideration. One thing for certain is that massive structures which defy our imagination must be constructed in the near future.

FABRICATION SUPPORT

It is estimated that the oil companies may invest as much as $1.85 billion in deep water systems. At least 50 percent of these monies will be spent on platform fabrication. As technology continues to press the industry towards deeper waters, ever increasing demands are places on the contractors for fabrication acreage. Jacket fabricators wishing to gain a share of the deepwater market require large fabrication yards, deep loadout basins, minimum of 25 feet deep channel access, reliable and cost-effective labor pool.

In order to be responsive to these requirements, we in the fabrication industry are faced with large capital expenditures to be ready when the need arises. In addition, to these expenditures, we will be faced with significant amounts of money for training workers, in order to maintain a reliable and cost effective labor pool.

In conclusion, I think we would all agree that it is in everybody's best interest if we can continue to cost effectively develop our oil/gas reserves. In order to assist in this effort I would like to strongly urge the oil companies to open up discussions with the fabrication industry so that we can work together closely in planning our mutual long-term strategies. I recognize the potential offshore developments are held in the utmost confidence by oil companies to maintain their respective competitive positions; but I feel that discussions covering an overall viewpoint of future developments is worthwhile.

I feel, that we can work together, we should be able to improve our individual profitability in these topsy-turvy times.

OFFSHORE/MARINE TRANSPORTATION AND SERVICE

WILLIAM C. HIGHTOWER, Tidewater Marine Service, Inc.

The comment was made a little earlier that if this meeting had been held back at the end of 1985 that there would be doom and gloom. But after the performance in the first quarter this year the doom and gloom from last year would be squared to show the increase. As everyone knows the budget cuts announced by the oil companies in the first quarter have ranged from 25 to 40 percent.

Those numbers are a little deceiving because they are very general numbers, but when you start looking at the specific numbers you see that the cuts affecting drilling and supply boats that support drilling are even more dramatic. The significant impact we have seen so far offshore from these cuts has been more domestic than foreign. The best way I can describe what appears to be the domestic oil industry position offshore is that the oil companies are taking a sabbatical. Since December of 1985 the rig count in the Gulf of Mexico has fallen 50 percent to a current utilization rate in the 40 percent range, and some people say it may go to 25 percent.

The foreign business has held up fairly well in light of the decline in the U.S. Gulf of Mexico. The rig count from December 1985 to today in the foreign areas, excluding the Gulf of Mexico, is only down 10 percent. This is much less of a decline than in the domestic area. One interesting statistic I saw this morning, which seems to be accurate is that this is the first time that more drilling rigs are operating in the North Sea than in the Gulf of Mexico.

What has been the impact of this downturn on the marine service industry? Up until the end of 1985 we had been in steady decline for the last four years. In the past three months we have added more and more fuel to the fire so the impact is very bad. We have excess capacity; we have a very low rate structure; utilization estimates in the Gulf of Mexico for marine support equipment would be in the 50 percent range while the foreign areas are estimated at 70 percent. My estimate of worldwide idle supply boats today would be about 500 boats.

As a result of the excess capacity, low rates and increasing cuts in the first quarter 1986, we have the continuation of a bad situation, but now at an accelerating rate we are seeing increasing bankruptcies, industry consolidation, more vessels being returned voluntarily to the U.S. Maritime Administration and more vessels being tied up to minimize costs. An example of contraction in the industry is the 1986 Offshore Magazine Annual Survey of Marine Transportation. In 1985, 443 companies responded to that survey, while in 1986 only 187 companies responded. On a worldwide basis through consolidations and decline in available capacity we have a marine support industry that is very rapidly becoming an industry where the number of capable players is being reduced to the range of five to ten companies. Given this sort of environment, what is the strategy for survival?

When you listen to theories on oil prices and what could happen, you realize drilling contractors are very vulnerable. When you support an industry that can be that volatile - and we as contractors do support the offshore oil drilling and production industry - you must remember that when it falls off you go with it. Simply put, the strategy for the near term and the long term is capital preservation. Maximize cash flows and minimize costs.

As you know supply boats are not only used in exploration drilling, but also development drilling, and to support production around the world. Fortunately, a number of our marine units support production, so as long as production continues we can maintain some utilization. Our emphasis is to secure employment in the production oriented type jobs on the short-term type work and concentrate working in countries where we know activities will continue. Brazil was mentioned as a country that needs self-sufficiency. Mexico is an example of a country that has to export.

Tidewater is fortunate today in that we are a worldwide supplier and that two thirds of our fleet currently is outside the U.S. Gulf of Mexico. We also are trying to do our part to reduce capacity in the industry because things cannot get better until capacity is reduced. In the last two years Tidewater's fleet has been reduced by 163 vessels. Our current fleet count is 280 units worldwide. The vessels being repossessed by lenders and being turned back to the U.S. Maritime Administration will help because most of those vessels will not work for some period of time. There is tremendous emphasis on cost reduction, and we have had great success in being effective in that area. We also continue to seek new markets. We have had some success in moving our equipment into general marine type support activities away from the oilfield by working on government projects. In addition, Tidewater has two other divisions, a gas compression division and an oil and gas division that are both continuing to be viable. We hope oil prices will stablilize and a long-term increasing trend will develop whereby drilling can once again continue on a stable basis.

OFFSHORE DRILLING CONTRACTOR

GARY L. KOTT, Global Marine Drilling Co.

There is not much more I can add to what has been said about the rig count and the health of the offshore drilling rig industry. At present it is almost a non-industry. Our decline is now in its 50th month. As stated earlier our customers, the oil companies, have basically put on the brakes while they evaluate their cash flows and their futures.

I have never seen more turbulant times for our customers. We are in uncharted waters. What will the oil price be? Will it hold? When will gas deliverability decline to match the reserve base? What will the tax bill do to the industry? What will happen to the major suppliers in the Middle East? All of this has been translated into record low levels of utilization.

Present day rates will not even cover our cash costs in the Gulf of Mexico, let alone service debt. Global Marine sees a continuation of this trend into 1987 even though the fundamentals of oil price and other key factors will improve probably later this year. It is going to take a good while for the oil companies to get cranked up to the levels that they have been in the past. The major question that is always asked to us in our industry is "What must happen to improve our day-rate structure?" The answer is probably no one thing but a combination of many. Obviously our demand must improve. Some of the older rigs must be retired and not resold, but for some reason old rigs never die. There must be a reduction in the number of contractors. We have a very fragmented industry.

I know many of you have had economics in school and probably remember the definition of a perfect economic market. The offshore drilling industry and the offshore boat industry are good examples of perfect economic markets. What makes a perfect market? A lot of competitors, a lot of customers, wide geographical dispersion, and between contractors today there is not a large product differentiation or service differentiation. We can all move our assets around. The one difference in our perfect economic market is the elasticity of demand. There is really no elasticity in demand. If we cut our prices to zero, the oil companies will not drill any more. So, all of these really work against our industry. There are 59 contractors in our industry with three or more drilling rigs. In fact, the top five competitors have only 30 percent of the market. The largest competitor of our industry has 7 percent and a huge capital investment well over a billion and a half dollars. The second largest has 7 percent, the third largest, 6 percent, the fourth largest which is Global has 5 percent and the fifth largest has only 5 percent. So you can see we have a very fragmented industry.

Rig stacked contractors will not be putting their rigs to work unless they can get better than cash breakeven and substantially better. I think that is going to help our industry. As long as a rig is working you will continue to work it at somewhat less than cash, but once you get a rig stacked most contractors will choose to leave them stacked because of the expense of mobilizing the rig. Some of the rigs in our industry must be semi-permanently stacked. The other thing that will help is that some rigs will be sold into semi-captive markets such as in India and China. All of this will help to decrease the supply side. Slowly the supply and demand situation will come into balance and begin to return our industry to profitability.

I am quite concerned, as are others in our industry, about the impact that a prolonged downturn is going to have on us. It is going to destroy our most critical element, our manpower base. We are already seeing our critical people, who have transferable skills such as mechanics, electricians, sub-sea engineers, captains, and marine personnel moving into other industries, probably permanently. Many of them have been burned badly. Maintenance on rigs that are not properly stacked will cause excessive start up problems. Last but not least, many companies will not have the financial muscle to continue in their current form if this downturn is prolonged. In the longer term however, we are not predicting the demise of our industry. We think there is going to continue to be an offshore industry. This steep decline we see today will probably be a steep increase over the next several years. But, I cannot predict exactly when the upturn will come.

UNDERWATER SERVICES

J. WESLEY ROGERS, Oceaneering International, Inc.

One issue facing our industry, is touched on in a quote from Will Rogers some 70 years ago. Will Rogers said "Oil was never much higher, but there you have a business that is in the hands of a few men and they see that the price is kept up. It is not regulated by supply and demand. It is regulated by manipulation." The problem today is simple, we are just not doing a good job of manipulating the oil price. It is interesting if you think back, that first the oil price was regulated by the Railroad Commission, in fact, the price was set. Then we went through a period that the "seven sisters" set the price effectively. Then OPEC did it for awhile, and all of the sudden maybe supply and demand is coming into play for awhile before somehow we get the few men back together that can regulate the price.

The impact on the underwater services business has been just as dramatic as the drilling or the boat business. I was glad to hear that we were not included in the perfect economic market because I think ours is worse. To really look at the underwater services business one has to take a look at the phases of the industry because we work in the exploration phase in the drilling segment and we work in construction when they are putting in new pipelines and new production jackets. Finally, we work in the construction phase which is really inspection maintenence and repair, which is about one-half of the underwater services market. But at the same time one has to look at the geography because now the Gulf of Mexico looks like the market for underwater services will be off 65 to 70 percent, but worldwide the market will be off only 20 to 25 percent. That is a function of taxation where countries like the United Kingdom have had a very stable taxation policy that encouraged development of new reserves. There are some countries such as Brazil or India that are going to continue drilling whatever the price, because it is a matter of their foreign reserves and of national policy. And then the OPEC countries, of course, have their own motivating factors. So different countries are progressing at different rates.

My remarks will focus primarily on the American market because I think that is what we are most interested in. Unfortunately, it has been the hardest hit of all our markets worldwide. Oceaneering is fortunate that only about 15 percent of our business is in the Gulf of Mexico, and it looks like that is going to be significantly less in 1986. The reasons that it is off cuts across all of the phases. The drilling business is down for the reasons that Gary and others have talked about. Construction is down this year primarily because of the gas pipeline companies have had their own challenges. They are dealing with block building and with the fork problems and they are not doing nearly the construction that they have in the past. That was one of the main markets for the underwater construction business. Surprisingly to us the inspection maintenence and repair markets have not held up nearly as well as we expected, because of postponement of work. I have had one company tell me that they are not doing things that legally they are supposed to be doing. Probably it is fine to put it off for a year in that they will be able to catch up next year or in years in the future, but it has been a dramatic fall off in that business that we certainly did not expect.

We have often said in our business that it had to get worse before it can get better, just from the standpoint that some of the competition and things had to go away. Since 1983, there have been 20 companies that have merged or have gone out of business, seven of them have actually just completely shut down and gone out of business, while thirteen companies are either quasi-broke and they were acquired by someone or they have just merged with other companies. Everyone in the industry today is loosing money. They are a number of the smaller contractors that are going without liability insurance. They are saying that they cannot afford the insurance premiums which have tripled and quadrupled this year and their company is not worth much anyway. They are saying, "so what if I get sued; let them come after me". This is probably a good strategy because it discourages the lawyer working on contingency to go after someone from whom he cannot get any money. It sure makes it tough for the rest of us. Most of the diving contractors in the Gulf of Mexico have laid off up to half of their staffs. They have made dramatic cutbacks in response to a market that will be off 60 or 70 percent this year.

One of the positive trends is that the technology continues to advance. Certainly we look into the future and see that the economics favor offshore development because the reserves are still there while most of the on shore reserves have been explored. Our industry has always responded with more cost effective methods and new technology to lower the cost to the oil companies in going into deeper water. We see that the deeper water remote control vehicles with their many uses will continue to evolve because that is cheaper than putting the man in the water. We see that automated welding and other systems will continue to evolve. It is interesting that most of that is taking place overseas where it is supported strongly by governments or where the governments muscle the oil companies to put in development money. Certainly in the diving business today, the center of technology is in the North Sea. Part of that is by necessity and part of that is by government policy, but it has certainly left the U.S.

The U.S. diver does not work overseas today. It is totally a foreign industry because of the liability problems of the Jones Act. Ten year ago we were the only people in the business and certainly dominated the worldwide markets, and today the U.S. underwater industry is not even a factor in the worldwide markets except for the international companies. In the long term we see that the growth will come back, but we think it is going to be a couple of years.

"From an Exploration and Development Standpoint, What Can We Expect to Happen in the Offshore Oil and Gas Industry Over the Next Two Years"

WILLIAM J. JOHNSON, Standard Oil Production Company

I am sure from what you have heard this morning and what you have read that the outlook is not that bright. I am afraid that in the next couple of years you are not going to find a lot of good news. I have heard it estimated that for each $1 billion in capital spending reduction by oil and gas companies that some 20,000 jobs in the industry are lost. If that is true, over the last 60 days as the result of budget reductions that we have taken in our company, I have been responsible for putting 10,000 people out of work. That is a pretty sobering thought. I assume, however, since you are here that you still have a job, so I will not be talking to any of those 10,000 people today.

I want to approach this subject in several ways. First, a brief description of the situation and a look at the cause. I want to (1) look with you at leasing patterns in the Gulf of Mexico and see if we can draw anything from that that might help us look into the future, (2) discuss the economic and cost trends in the industry presently and then (3) talk about when and why we might expect to see a change.

Exhibit #1 describes the situation very well. It is a plot of the available rigs in the Gulf of Mexico on line A and active rigs on line B. What appeared to be a shortage of rigs in the Gulf of Mexico about a year ago has quickly become a massive overcapacity. Utilization as you know is down below 40 percent now. The jackups have been hit the hardest but the semisubmersibles are coming down now as their contracts expire.

Exhibit #1

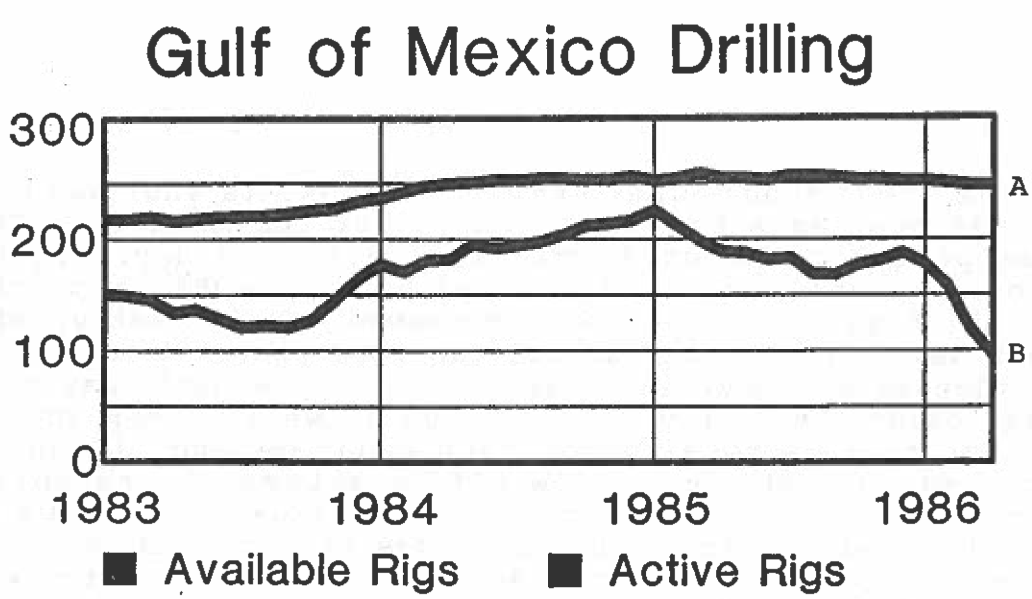
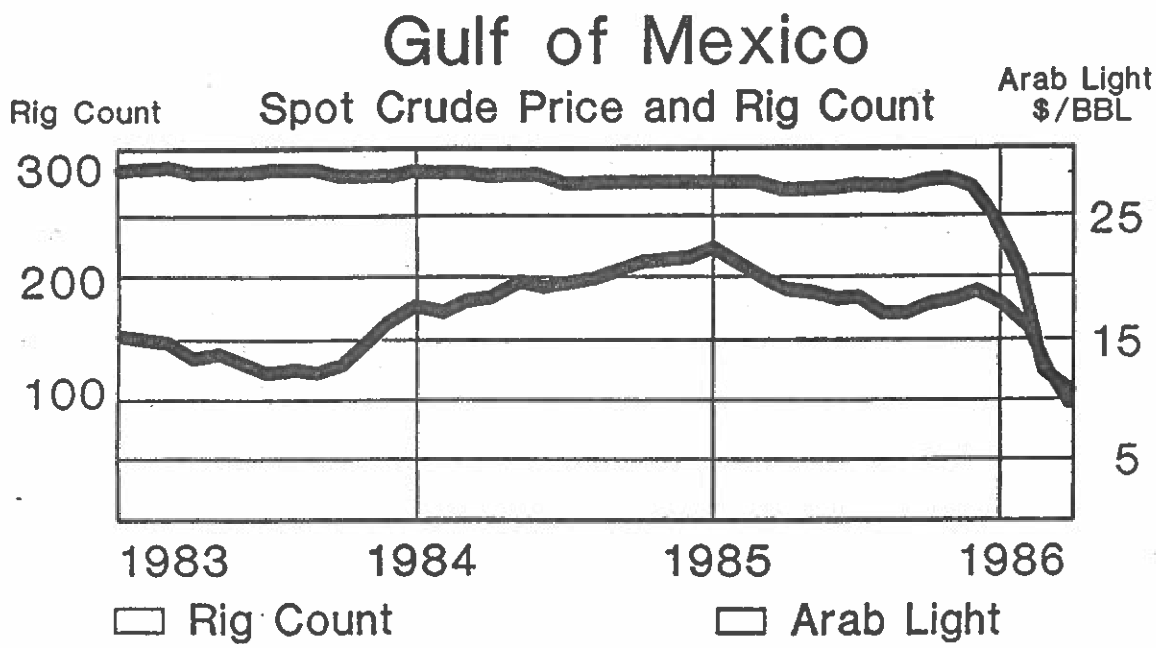


Exhibit #2 provides a rather vivid description of the situation we are in right now. It decribes the tie between oil activity and oil prices. What you see on the tail end of that chart over to the right is a rapid reaction by the industry to falling prices, damage control if you will, conservation of cash.

Exhibit #2



This is the reason. What Exhibit #3 shows is what has happened in the last ten years to OPEC's control of the markets. In 1974, OPEC was producing about 31 million barrels a day. In 1985, a little over 17 million. On the other hand non-OPEC production in response to high oil prices has increased significantly, about 10 million a day. The CPE on the diagram is a planner's way of saying central planned economy, and that is also a planner's way of saying communist countries. They have come up as well. When you look at the bottom, that is total production equal demand, demand really has not changed that much. Now OPEC's attempt to recapture the lost markets is what has precipitated the situation that we have in the industry today, along with the loss of expectation of higher prices in the future. It is my feeling that the situation will not reverse itself very quickly.

Exhibit #3

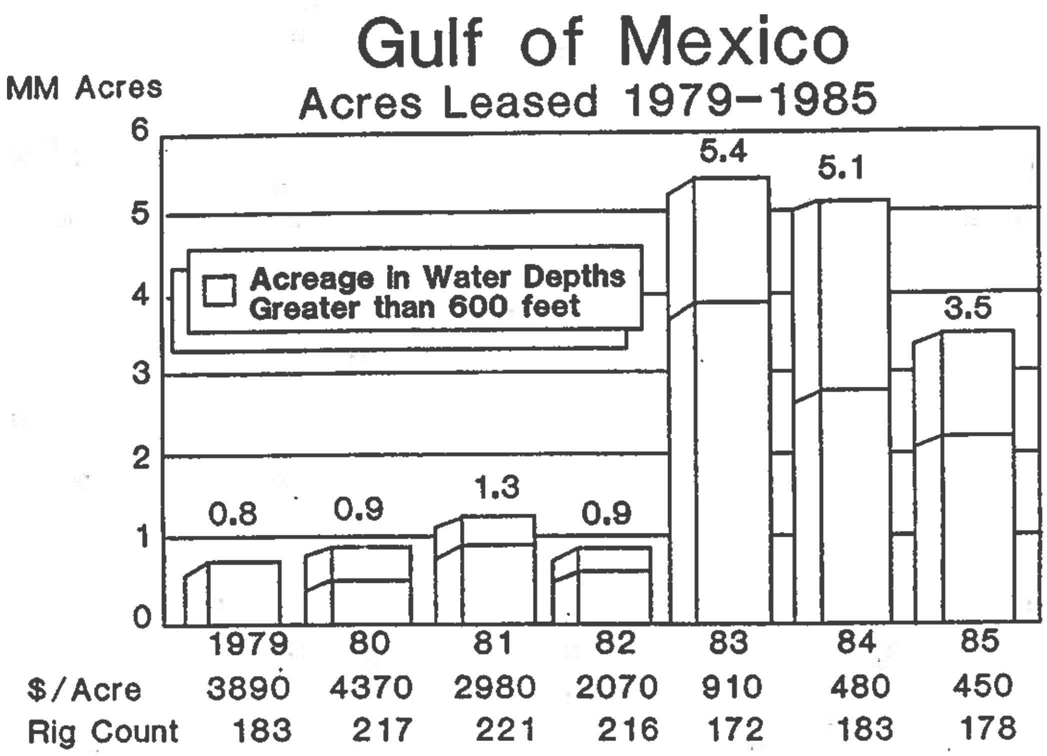
World Production

Oil and NGL's
(MMB/D)

	1974	1985	Change
OPEC	31.1	17.4	(13.7)
Non-OPEC	16.5	26.7	10.2
CPE	11.0	14.8	3.8
Total World	58.6	58.9	0.3

Exhibit #4 shows the leasing trends in the Gulf of Mexico since 1979. The upper portion of each bar represents leases taken in water depths greater that 600 feet. It tells a pretty good story in that between 1979 and 1982 where we were in a situation of nominated tracks, we had a low volume of leases taken at a very high price. If you will look at that first string of figures there at the bottom, dollars per acre, you will see that it ranged on an average from about $4,400 an acre to about $2,000. In 1983, we started area-wide leasing. The whole Gulf of Mexico was thrown open for leasing at one time. As a result the leases became high volume and the cost became low. And also the trend into deeper water accelerated.

Exhibit #4



One thing that fueled some of the activity and leasing in the Gulf of Mexico in the last few years has been the expansion of the so called Flex Trend or the Plio-Pleistocene Trend. This has been the hottest play in the Gulf of Mexico for some time now, at least two years. On Exhibit #5 you will see the platforms that have been installed or ordered in this trend and the indicated discoveries. The trend basically is in deep water, 600 feet and deeper. It is expensive and it is very vulnerable to low oil prices. So far there are 13 platforms, seven installed, six ordered, and nine announced discoveries. My best guess is that there are probably about five in addition to that number. Activity in the trend is drying up rapidly even though it probably offers the best potential for adding reserves fairly quickly, the best potential of any play in the U.S.

Exhibit #5

PLIO-PLEISTOCENE OIL TREND

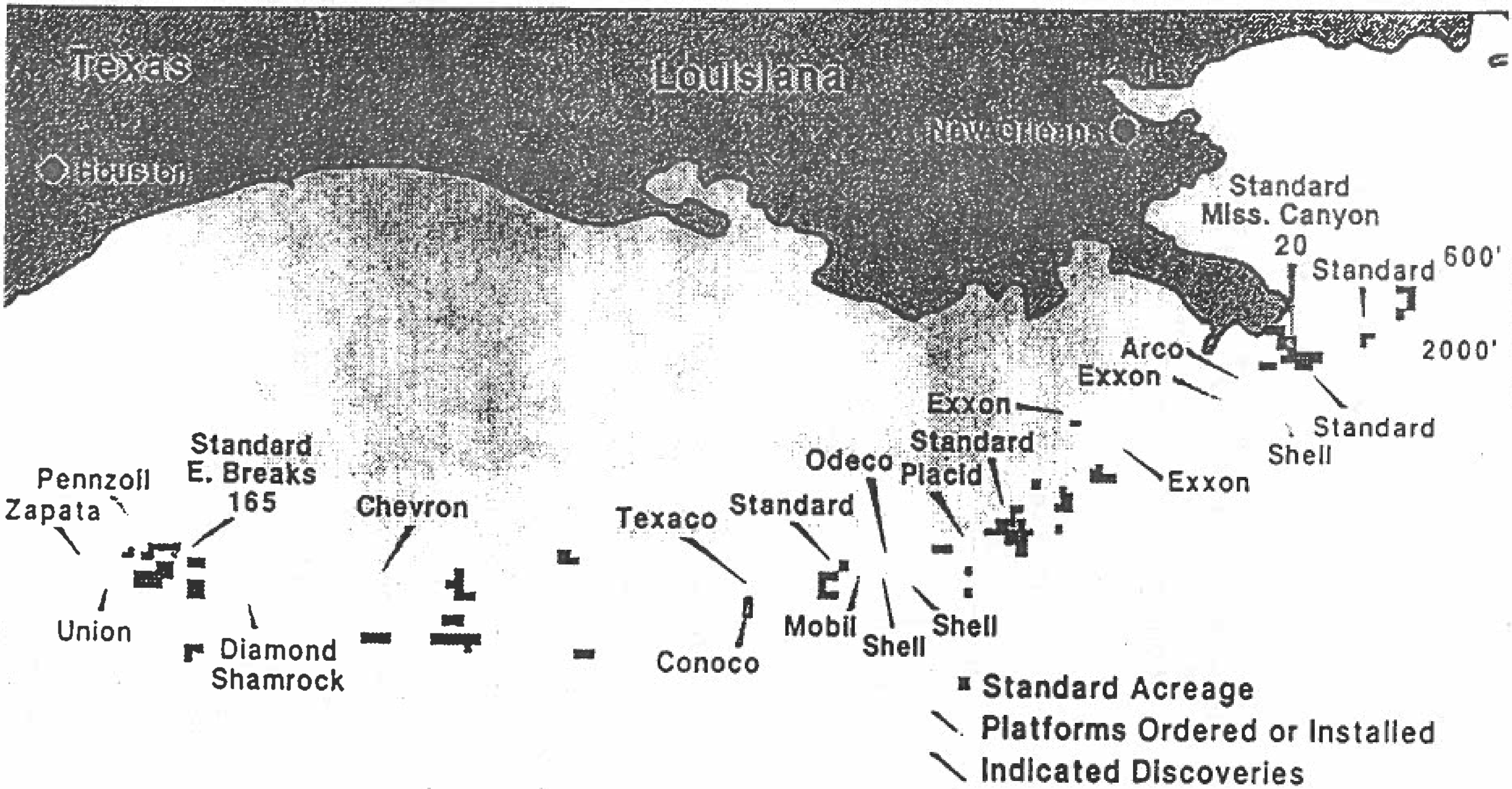
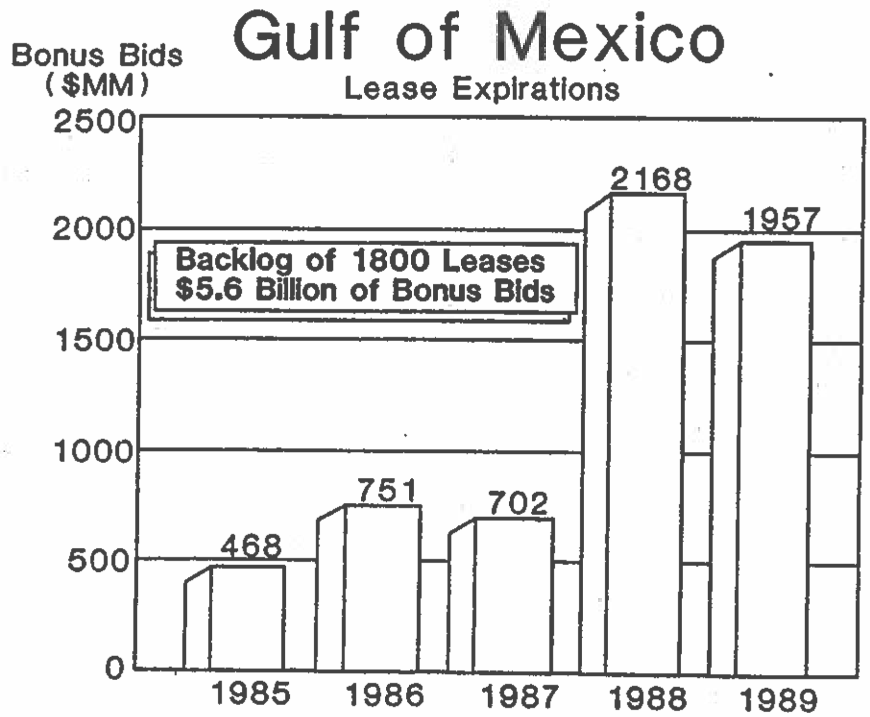


Exhibit #6 shows the exploration date of leases in the Gulf of Mexico which have not been qualified for OCS Order Foor. OCS leases are a wasting asset. You have got them for only five years. There are about 1,800 leases under zero with a bonus paid for those leases of about $5.6 billion. 1988 and 1989 are the big exloration years, that is 5 years following tha advent of area-wide leasing.

Exhibit #6



Source: Zapata Corp.

I guess the big question is "Will these leases get drilled?". I think many of them will not. The relatively low prices paid for these leases do not drive the operators to drill them as quickly, or even to drill them at all, as did the higher prices that were paid before the advent of area-wide leasing. Said another way, if you paid $25 million for a lease and it cost you $8 million to drill it, you are going to get out there and do it. If you paid $2 million for a lease and it cost you $8 million to get out there and do it, you might not, particularly in a cost and price environment like we are in today.

Exhibit #7 shows the margins for exploration and production activities that we as an industry have realized, domestically, over the last 10 or so years. You can see that the rapid expansion in margins increases in finding costs and operating costs. But still greater expansion in margins started really dramatically about 1979 and peaked out about 1981. Finding costs and operating costs started down, and margins held up. By the time you get over to the right hand side of the chart you can see what is happening to us. That period from about 1979 to 1981 has been amply described. Bob Palmer with Rowan Companies described it as "a state of euphoria accompanied by a complete lapse of memory." Well we are getting our memory back now, I guess, with the decrease in margins. You go ahead and project the trend out for another year or so, exploration at the current crude prices in most places in the country just does not make a lot of sense. Something has got to happen to change that.

Exhibit #7

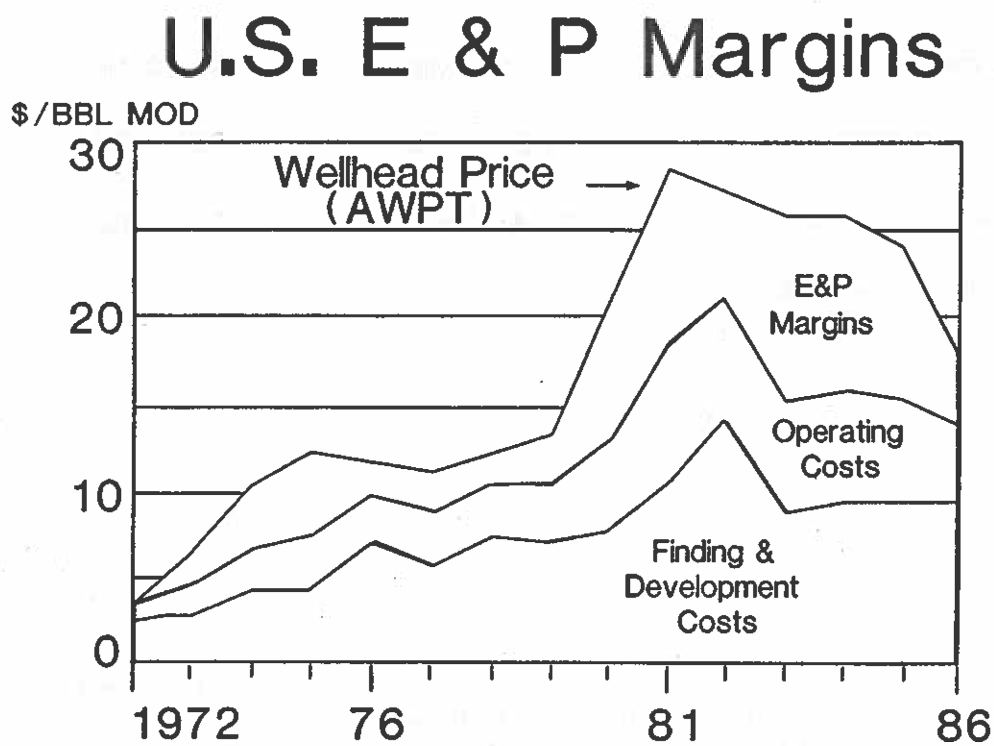


Exhibit #8 is the economics of a Gulf of Mexico development project in 900 feet of water, or the Plio-Pleistocene trend. On the left is a 25 million barrel equivalent discovery, probably about 50 percent gas and 50 percent oil. The diagram includes the exploration costs (which by the way do not include lease hold costs) and the development costs that would be incurred to develop this project. Also included is the breakeven crude price that you would have to have, flat-real (and when I say flat-real that increases only by the rate of inflation), to just get your money back, not to make a dime, is about $16.50 a barrel. If you blow that development up to twice the size, 50 million barrels equivalent, then that flat price comes down to about $7.50 a barrel.

Exhibit #8

Gulf of Mexico Development Project

Reserves	25 MMBOE	50 MMBOE
Water Depth	900'	900'
Expenditures		
O Exploration*	$ 29 MM	$ 29 MM
O Development	$222 MM	$290 MM
Breakeven Price (0%)	$16.48/BBL	$ 7.40/BBL

*Excludes Leasehold Costs

That only tells part of the story because that project probably has to carry 5 to 7 dry exploration prospects for the company involved in this activity to even get its money back. With those kind of economics, what does make sense? I think one thing is that you are going to see a number of companies, those that can afford it, whose balance sheets can stand it, looking very seriously at acquisions.

On Exhibit #9 the top line shows present value of major reserves, that is the present market value of major reserves which back in 1984 was about $3 to $5 a barrel equivalent. The mega-mergers that occurred in 1984 and 1985 was bought by the acquirer for some $3 to $5 a barrel. If you put in the smaller acquisitions, it went up to about $6 to $8. Finding costs for the 30 majors that were looked at in this study was about $8 a barrel, finding and development. Those two numbers for the acquisition approved reserves, at $3 to $5 for the bigger mergers and at $6 to $8 for all acquisitions, has come way down. In fact, it is considerably below the $8 finding costs at the present time for reserves that are for sale.

Exhibit #9

Find vs. Acquire Economics

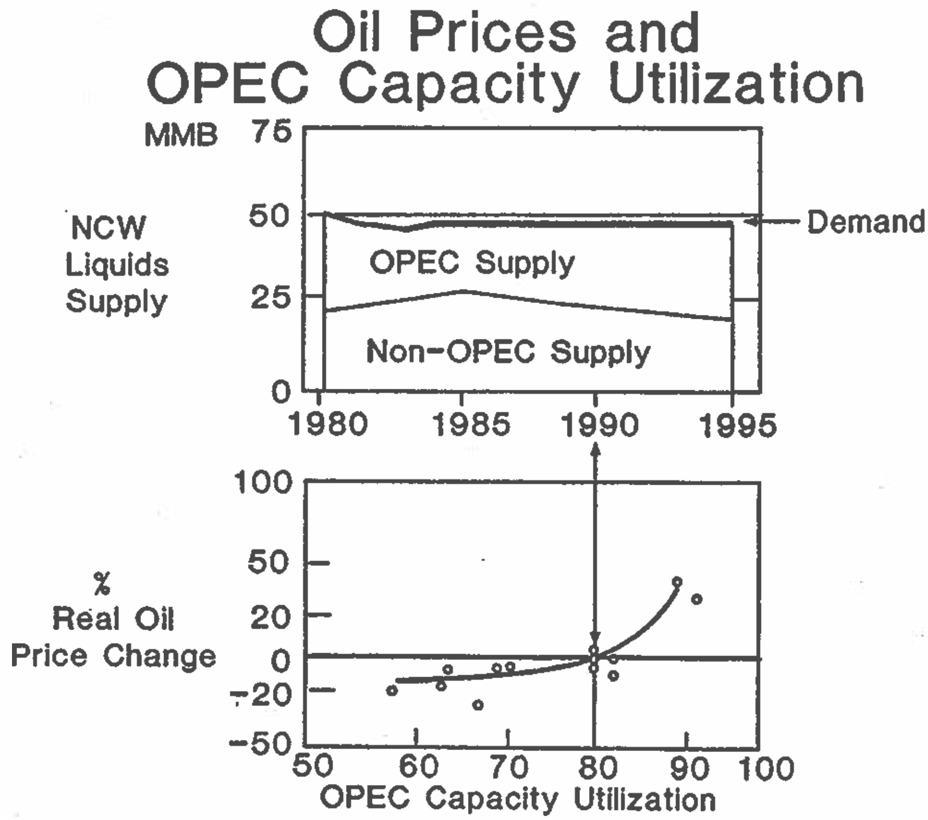
	$/BOE
Present value of majors' reserves (1984)	3-5
Cost to acquire proven reserves	
o "mega-mergers"	3-5
o all acquisitions (1982-84)	6-8
Finding costs for thirty majors (1984)	8

Source: Salomon Bros., Inc.

We looked a little bit at trends, what happened and how we got where we are. Now I want to talk a little bit about what the future might hold and why.

Exhibit #10 is a fairly busy chart. At the top is a chart labeled NCW Liquid Supply, that is Non-Communist World Liquid Supply. It is broken down into OPEC supply and non-OPEC supply. The assumption on the top of this chart is that the demand will stay flat. That is probably a conservative assumption in today's price environment. Now, drop down to the lower chart. What this shows is the annual increase in crude price plotted against OPEC's capacity utilization. What the bottom chart says is that when OPEC is at about 80 percent of capacity, they are in a position to move oil prices in the direction they want. The non-OPEC supply, assuming that very little money will be spent on large new projects begins to naturally decline as shown on this chart so that in OPEC supply moves in to take up the slack.

Exhibit #10



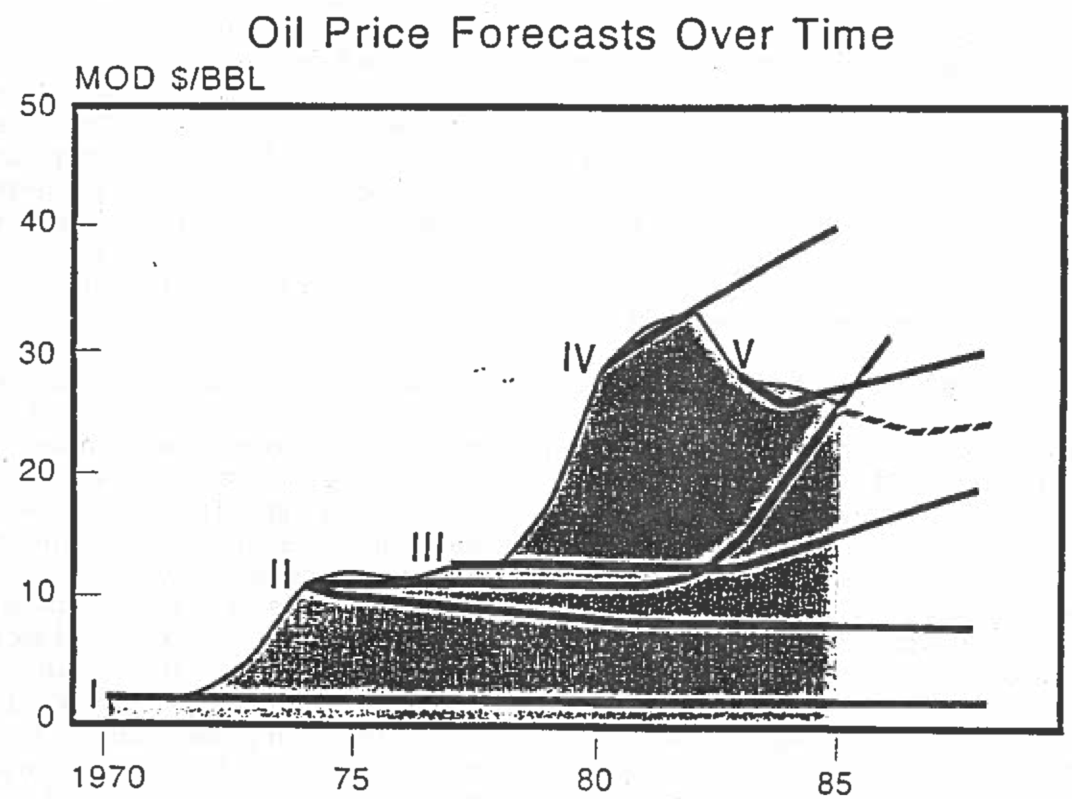
When you put these two together the answer you get is that in around 1990 with OPEC at about 80 percent of capacity then prices will be once again at least partially under their control. This is a look at the natural forces and when they will converge. Of course there could always be a political solution that would change this sooner.

Between now and the 1990 period I think that we will see prices cycling seasonally. Low prices in the spring, firming up in the summer, higher prices in the fall and back down to lower prices again. The reason being is that the refiners are living hand-to-mouth, there is no crude inventory to speak of. As a consequence, the choice that they have made is that they will pay the price rather than carry the inventory in the volatile oil pricing environment like we are in now. As a consequence, we are going to see cycling and I do not think that when we see oil prices moving up late this year we ought to all get excited about it because I think there is another side to that hill.

The conclusion I reach is that we have got to live with this situation for a while longer. In so doing, all of us, operators, contractors, alike are going to have to take some innovative steps to keep our cost down, toughen up, change our strategies, combine forces in order to work our way through this period. Even if prices do improve, considering what we have just been through, that memory that we had a lapse of back a few years ago is going to prevail, and you are not going to see a rush to spend. I heard some discussion this morning about the situation bouncing back and what would be the problems of supplying the demand if there were a bounce back. I frankly do not think there will be a bounce back. I think there will be a firming and a slow trend and in the 1990's, we will see things beginning to get better at least from a price standpoint. But I do not believe that we are going to see oil in today's terms much over $20 or $25 a barrel.

Now, having made that prediction, I want to show you Exhibit #11, my last chart. This was put together by Arthur Anderson and shows the oil price in dollars per barrel, money of the day, from 1970 through 1985. The Roman numerals and the lines that follow those Roman numerals are the absolute consensus opinion of the trend in oil prices that prevailed at the time. Find me one of them that tracks the oil price. The one on the right hand side, the broken line was a prevailing opinion back in November of 1985. It is already out of line. So, I think you need to take my comments in this context, they are about worth what you paid for them.

Exhibit #11



"Management Strategies for Survival"

Panelists:
CORBETT U. ALLEN, JR., Corporate Restructuring, Inc.
JAY M. COURAGE, Simmons & Company International
J. CRAIG COWGILL, Cowgill and Emmott
MARK S. WORTHEN, Texas Commerce Bank

CORBETT U. ALLEN, JR., Corporate Restructuring, Inc.

The basic management strategy in crisis for this industry for the forseeable future, is seen in companies that survive to enjoy the turnaround and profit from it, but are going to operate like there will be no turnaround. These companies, and there are very few, will learn to operate in this kind of market environment in our industry. This time in our industry is a time of opportunity. Companies with good management and strong financial resources, and who operate like there will be no turnaround, will survive and will make a ton of money when the turnaround comes.

Slogans such as "Survive through 1985" obviously are no good. Anybody coming up with those kind of slogans has the wrong mental attitude. One of the specific actions talked about this morning is consolidation. There is just too much overhead out there and it creates price cutting in the marketplace to a fault. People are actually bidding contracts at below cash costs just to keep assets and people employed. There is certainly not enough good management to go around. The biggest single hinderance to consolidation in our industry is the ego of the chief executive officer of most of the companies. The CEO would rather sit there and be number one than consolidate and be number two in a company.

There also needs to be a change in emphasis on the senior management level from a production-oriented management to a marketing and finance-oriented management. If you just think about our industry and the people who have started the companies, and many who are still running companies, they were drillers, divers, barge operators, and production people. That resulted in the major emphasis in running the company being on production. It meant CEO's who said, "My product, my service, my piece of equipment or the way I designed it, is the best and even if there is downturn the oil company customers are going to flock to me because I have the best." The only problem was that every single company in the industry thought they were the best. Marketing was nothing more than OTC parties, cowboy boots, and drawing trend lines through the graph of the rig activity over the years. There are still CEO's who sit around with the rig count going back 20 or 30 years drawing that trend line starting from day one and saying, "We have got to come back to this trend line." That is their marketing program.

Cash is now king. It is shoe box accounting, cash in, cash out with minimized leverage. This is and always will be a cyclical industry. What is good going up is bad coming down, but it is worse coming down. I bet you cannot find a CEO in this industry that has not said he has cut cost to the bone. But, there are still good ole boys sitting around with virtually nothing to do, most of them production people, drawing heavy salaries. The excuse is generally, "We may get this next contract or we may be opening up southeast Asia or we will need those people, or we cannot get them back." Realistically, if you get the work and the people are not there, you can still get good people back in todays market.

The important ingredients are emphasis on finance and marketing, realizing cash is king, cost controls, and close communication between borrower and lender. It is amazing to me that companies will go to lenders, borrow money and as soon as the money is in the till, no communication. Lending agreements almost always call for monthly financial statements, but rarely does that happen, or if they do happen, they are late, incomplete and often impossible to analyze. There are companies that have continued to make a profit in today's market conditions, because they have emphasized marketing and finance. It is important to have a good product and/or good service, but that is like having one leg on a three legged stool, and a company that does not have all three legs is going to fall.

STEPS TO SURVIVAL

We have all heard about the problem of getting directors and officers liability insurance. The finger has always been pointed to the insurance companies, to the courts or to ambulance chasing lawyers. The finger has never been pointed at the directors themselves and that is where it belongs. Directors have totally ignored their responsibility to the shareholders of the companies on whose boards they sit. When they come to board meetings, and are presented a financial, they seldom read it. I have presented board members with detailed financials, and they would look at the first page and say, "We are in trouble." They come to the meetings, hear a very shallow presentation by the CEO, collect their checks, complement the CEO on his presentation and go home. They are passive, loyal supporters of the CEO. By the time it becomes obvious that the company is in trouble, it is usually too late. It may be obvious to a lot of other people but not to the directors because their first loyalty is to the CEO. The first step in our industry, and other industries to greater or lesser extents, is to go to a professional board of director type situation where directors are adquately compensated for spending a lot of time on company business; who understand their loyalties are first to shareholders for the survival of the company, and who are willing to use their power.

The second step in the key to survival is the CEO because he is really the key. If a company does not have a detailed business plan, it's chances of survival are slim to none, and the CEO is responsible for seeing that the company develops a detailed plan. If he is not dedicated to it, it will not be done. I have been in numerous situations where a detailed plan, at the instigation of the CEO, is developed, and maybe in only 5 percent of those situations it is followed because the CEO does not insist that it be followed. Every time an opportunity comes up that is not even remotely related to that plan, off they go in that direction. In general, the CEO is one of our industry's biggest problems. A lot of them are entrepreneurs, and entrepreneurs are to be complemented, admired and respected for their accomplishments. But, as the company gets larger and the industry gets more complex, they cannot handle it. It requires delegation, and they cannot do it. They are naturally optimistic or they would not be entrepreneurs. Therefore, as the industry is wallowing in the depths of depression they are constantly thinking, "Well, next year or six months from now." Their attitude is not conducive to what needs to be done.

SPECIFIC PLAN

There are companies that make a profit, even in today's market. They did not depend on high debt financing for growth because they realized the market was cyclical. They had a detailed, well thought out plan and they stuck to it. They were marketing oriented and picked markets where they had a special nitch and could make a profit. They had strict detailed management and financial controls and they reacted very quickly when actual results indicated corrective action should be taken. When corrective action was cost cutting, they cut costs. If the corrective action was cut a division or cut a line of business, they did it. They did not keep things going just because they thought the market might turn around. They did not bid or alter their numbers in bids to make the bid numbers come out like they needed them to get a job. Some managers often take a look at the estimated costs for the job, and if it is more than they thought they had to bid to get the job they will cut the costs. They get the job, but they lose money.

I have not been in a company that knows how to do a cash flow forecast. Basically, it is revenue minus direct operating costs, exclusive of non-cash costs like depreciation. It gives you your cash flow. Any time you start up an operation, you have start up costs, but you are going to be paying out money for payroll and payables especially in this environment before you start collecting, and never have I seen a company prepare a detailed weekly, monthly cash flow forcast prepared that way. They start up an operation and cannot figure out why they run out of cash. They have business managers in the field instead of the best driller or diving superintendent or boat operator. Their general managers in the field are general businessmen.

RESTRUCTURING

What about the companies who are already in trouble and have to negotiate to try to restructure their debt? What are their alternatives? Liquidation? Chapter 11? Restructure? Merger?

Taking the simple one first, liquidation is obviously a very drastic step, and practically speaking in today's market, liquidation does not bring much of anything because no one is buying assets.

Chapter 11 is also a very legitimate alternative in certain situations; however, in my opinion it is used too often. It is expensive in time, reputation and legal fees, and the solution tends to be legal rather than business. It is also confrontational.

Restructuring outside the protection of the courts requires all parties involved on both sides of the table to realize that they are together because their original expectations have not been met. There are no good guys or bad guys. When good guys and bad guys enter the picture the effort required to get the restructuring done is 20 times the magnitude required when you sit down and say, "We have all got a problem. We all contributed to it; we are all going to have to suffer; and everybody is going to suffer if the restructuring fails."

The first step in restructuring is for management to gather all creditors together and present a detailed presentation of the magnitude of the problem. Present a detailed cash flow showing the shortfall at meeting their obligations. Management asks for a standstill while a detailed plan is implemented. When restructuring starts, one thing noticeably lacking in most cases is the credibility of management. Projections have been given to lenders that have not been met, and plans have been submitted to lenders that were not followed. The first thing you have got to do is re-establish the credibility of the management team and that takes time. It takes putting a plan in front of the lenders and proving a committment to follow it. Lenders want to sit and watch actual results come in. If management cannot get results then restructuring is almost useless. Once the standstill period is over and everybody is fairly comfortable with the actual results being close to the plan, then management submits a restructuring proposal.

Some do's and don'ts in a restructuring: First, be patient. The lending officer that lent you the money is not going to be the guy you are going to be talking to. You are going to be talking to the special credits department. Credit departments are obviously overworked. So you are not going to get an awful lot of time. When you have a meeting and a presentation, make sure it is a very well thought out and valuable presentation to the lender. Do not waste their time.

You will not be dealing directly on a day-to-day basis with the decision makers in the lending institutions. You will not see the ultimate decision-maker very often. There is going to be a lot of different creditors with different views who are going to require a lot of educating. Prepare reports to overcommunicate -- monthly reports, actual versus forecast; revised forecast and update non-quantitative objectives in writing. Do not wait to send the monthly report to your creditors when major accomplishments are achieved or major problems arise. Do not let them find out by happenstance. Communicate to all creditors - secured, unsecured, trade credit, public debt. Do not ignore any of the creditors and never promise anything you cannot deliver.

Invite input from your creditors on how to solve the problem. Do not leave the communications between you and lender to your lawyer or investment banker. Minimize uncontrolled creditor problems especially with your trade credit. If you have many trade creditors, pay off all of the small ones if you can and get them out of the way. Wittle the list down to a controllable number because you are going to have a reduced staff trying to deal with them. Also, remember that any three of them can get together and require a chapter bankruptcy proceeding whether you like it our not.

In negotiating with the senior creditors, pick a negotiating group. Identify the influential institutions involved and identify the influential individuals. Get the most influential group to be your negotiating group. Negotiate the restructuring with them and have them sell it to the rest of the creditors.

Beware of hold outs. There are hold outs with some institutions that wait until all of the other creditors have agreed upon a restructuring, and then they come in trying to "improve" it. Do not neglect subordinated debt because they can bring the whole house of cards down. Most everybody else is trying to minimize their losses that most of the holders of subordinated debt are investors that bought in with pennies and are trying to make a profit.

Finally, what is the role of the restructuring specialist? You would normally expect the CEO and the CFO to lead the effort, but in most cases, they are too emotionally involved. Their nerves have been worn thin by impatience, confrontation and haggling with the banks. Their credibility is usually a problem. A restructuring specialist can lead the effort as a new face or new character. He is not trying to get out of a credibility hole, and he is not emotionally involved. He has one objective and that is to get the restructuring done. Once your restructuring is done, continue to follow the plan. If you are back at the table with the same people again, you want it to be obvious to everybody involved that the reason you are back at the table again is beyond your control and not because you did not do what you said you were going to do.

JAY M. COURAGE, Simmons & Company International

It is unbelievable to me how poor almost everyone's crystal ball has been in the offshore industry from 1980 through today. In fact, the only certain thing we can count on from now through 1991 is uncertainty. If we are doomed to having to deal with such a murky future, what are some of the strategies management can employ? The single biggest problem for the industry as a whole is learning how to cope with this uncertainty. The easiest course is for everone to hunker down and implicitly destroy the future capability of the industry because of the current low prices. This merely paves the way for upheavals in the early to mid-1990's that we experienced in 1974 through 1979. The industry needs to find a way to avoid this jerky course of action.

The companies that adopt a strategy of hunkering down to wait out these times had better have a lot off reserves and then be prepared to come out of the other end of the tunnel with less than they have today. The risk of this strategy is that the reserves finally deplete before good times return. I believe that the survivors who will lead this industry into the 1990's and beyond will be those companies who best adapt to the many changes, not those who wait out the storm. Those who find ways to provide the highest quality at the lowest cost, those who gear cost structures to the vagaries of the environment, finding ways of changing fixed costs to variable costs, those who make sure that a critical mass is maintained in a shrinking market.

Let me quickly share with you some observations of the actions taken by land-based, exploration-related service companies now into their 52nd month of pain, and see if we can learn from some of their active mistakes:

(1.) Cost cutting: You can line up three companies in almost any sector of the industry that has suffered for over four years now and still find a marked difference in the ability of the three to control their costs. First, effective cost cutting takes a peculiar and distinctive mind set. It is critical that this frame of thinking be established firmly and early on. Second, there seems to be a phenomenon relating to cost cutting that you can only cut so deep at a single pass, but when you go back for a rework, there is always more to take out. Third, the real bone versus fat and muscle is far smaller than most companies ever realize. Fourth, once cuts have been identified, act immediately.

(2.) Importance of cash: In this environment, cash is king. Many of the industry's public companies still do not specifically identify operating cash flow in any of their internal or external financial statements. To the companies nearing the end of their cash reserves, the time to act is now. Don't gamble your last cash on an unpredictable timing of a hopeful recovery.

(3.) Risk of doing marginal business: In good times, you can justify and defend loss leading and protection of market share at poor rates, but in today's climate you cannot continue doing business that essentially loses a company cash. In our workout projects, the first analysis we do is to identify the bottom 20 percent of a company's business and then try to convince management to shut it off. I would urge every company in these times to take all of your jobs and periodically rank them from the ones generating the most cash to the least, then concentrate reducing the bottom end.

(4.) Be wary of the business strategy that relies on the marginal competitor closing its door. Don't bank on your competitor dying. More often he will just pass his disease on to you.

What happens when you take all these steps and the business still doesn't work? Since our firm has been so heavily involved in the rash of combinations that have taken place over the last two years, it sounds almost self serving to preach the benefits of two or more competitors combining their operations. However, in the more than three years now since we first started analyzing our combination projects, no single idea has emerged from our firm, let alone any of us hearing of another better fix to someone's problems in the current environment, than to combine with a complementary competitor and (1) introduce the possibility of additional costs cuts through redundancies created; (2) regain some critical mass; and (3) more efficiently manage down the chronic overcapacity that plagues almost every sector of the industry.

To date 17 combinations have taken place, and some interesting patterns/trends are emerging from the list itself. First, the 17 cover 10 different industry sectors. Second, each of the participants in four of the first five combinations done have now gone back to do at least one more transaction. The forms of transactions have covered the waterfront, both as to their structure and as to their relative and absolute size. Several of the early transactions involved the most troubled divisions or relatively small parts of the parent companies. Few of these transactions have involved any cash changing hands and, in most, the "survivor" is a bonafide, new, stand-alone entity with a lean management team comprised of the best people from each entity.

The motivation behind every one of these ventures has been to create a more viable entity by shrinking costs -- making 2+2=3 from a cost standpoint while protecting the revenue base. In the short term, these cost savings have the most immediate benefit.

Over a longer term, the most important and lasting benefit is a more efficient managing down of the massive overcapacity of long term bricks and mortar and 20-year iron-type assets that plagues our entire industry. Have they worked? Absolutely, relative to the performance of the independent units. Had the market stabilized at the levels of late 1985 activity, you would have seen some excellent results starting to appear in 1986 from some of the early round combinations. Now, because of the dramatic fall off in activity, the successes must be measured in relative versus absolute terms.

If these have been successful in a declining market, why so few? The answer: they are hard to actually put together for a series of reasons. First, the concept is easy, but the implementation hard. They are tough to get closed and then take an enormous amount of management effort to make them work. The second problem is an absence of cash -- few of these transaction had any cash changing hands, which always makes a transaction harder to do. Third, is the pride of authorship/competitive jealousies naturally arise out of combining two long-time competitors/ rivals. Fourth, is the diffuclty of transferring highly leveraged assets into a new venture.

These are the problems -- none of them insurmountable: Having seen first-hand the enormous benefits companies have already obtained by combining several complementary entites, there is a great opportunity awaiting many additional participants who decide they would rather own a peice of a pie that works than 100 percent of a business that can no longer survive. Through these combinations will clearly come many of the industry's future leaders -- lean, low-cost producers doing one or two activities extremely well with the critical mass to still offer the high quality service and expertise demanded of the offshore environment.

My forecast for the industry's future is for uncertainty to continue. The solution to this forecast is not to wait but to forge ahead, as difficult as changes are. Don't wait for a recovery. Create your own.

J. CRAIG COWGILL, Cowgill and Emmott

There are five basic options in handling a bad financial management situation. The first option is to do an out-of-court workout with your creditors, but you have got to do it with all of your creditors. You should talk to the secured creditor first, including the Internal Revenue Service, because they usually have the biggest stick. Once you make a deal with them then you go to the unsecured and tell them what is left over and make a deal with them. The problem with out-of-court workouts is that you have got to make a deal with everybody. If you do not, it only takes about three creditors who will not agree and you are right back in the same boat and all of your out-of-court work has been for nothing. The second option is do nothing, which is a valid approach. Just keep on doing what you are doing.

The third approach is a Chapter 11 Bankruptcy proceeding. Everybody does not like Chapter 11. It is expensive, time consuming and it is an ordeal. Normally management is lacking and there is no emphasis on cash flow. The first thing I do when a company looking at Chapter 11 comes in is tell them to throw out all of their accounting information and find out what their cash flow is. Should you file Chapter 11, you continue to operate your business in the ordinary manner without court interference, unless you have to do something out of the ordinary, then you have to get court approval to do it. You maintain your bank accounts, your same business relationships with your creditors. The difference is that the date you file bankruptcy we take a snapshot of your particular company from a financial point of view. You cannot pay anybody you owed as of that day which includes everybody except those that are secured or those that have lease obligations. You can continue paying them, but everybody else will have to wait.

The first thing anybody tells me about Chapter 11 is that they were doing okay, but X company went into bankruptcy and owed them a lot of money, and that just killed their business. Just because somebody that owes you money goes into bankruptcy do not write that money off. Go seize the opportunity that is there. Chances are that company needs your product and you can go make a deal with the company to sell them your product and it is a lot better selling to that company in Chapter 11 then it is selling outside of Chapter 11 or before it hits. If you go sell a bunch of services or goods and they go into Chapter 11, they cannot pay you. If you sell it to them after they are in Chapter 11, they have got to pay you because you have priority claim for monies due you. You normally can make a deal with them which sometimes works and sometimes not. It all depends on the situation. You might add a little something on for what they owe you on the past bill just for extending them credit. While all of the other creditors are sitting ringing their hands wanting to know what to do, you are sitting there still supplying your goods, still getting paid for it and getting a little extra back on the amount that is still owed to you.

Chapter 11 is really divided into two sections, reorganization and liquidation. Unfortunately, for most of us until recently, liquidation has really been the only mode, that is, liquidate, take a loss and go do something better. This is changing and changing dramatically. Reorganization is becoming more of a viable concept because people are now willing to consider working with Chapter 11 companies and continuing to supply them, fund them, etc. For the banks I represent, when the customer comes in and says they are going into Chapter 11 the banks support the idea. They would much rather have loaned these companies money in a Chapter 11 than loaned them fresh money now. When they loaned them fresh money in a Chapter 11, they can go in and get a priority position with a lien on things, and not have to worry about hostile creditors.

The second advantage is not having to worry about management. Chapter 11 takes a lot of pressure off of our management because we have taken them out of the creditor business and put them back to work on our main business. Everytime we put a larger company into a Chapter 11, we always insist that the CEO hire a workout person to come in and take over all of the restructuring and all of the workout. We also want that company to designate a person or a group of people to handle creditor calls and handle our public relations with our creditors.

A third option is Chapter 7 Bankruptcy which is strictly liquidation. You loose all management control of liquidation. You hand the keys to the trustee, and he goes out and liquidates the company, and it is all over. As the assets are identified and liquidated, we have a priority of payment schedules in the bankruptcy code that tells us each level creditors are to get paid and, as the money runs out, the other lower priority creditors do not get paid. The Chapter 7 occurs when the horse is just absolutely dead and there is no way of reviving it. The benefits of the Chapter 7 are that you bring a bad situation to a distinctive conclusion.

We have a saying in the bankruptcy business and that is "so goes the corporation, so goes the principal." A lot of times the corporation is our client but the principal is our real client because you cannot be running a company worried about what is going to happen to the principal. So, you have to address those issues. If you have a company, and you personally guaranteed everything, then not only your company has serious problems, but your personal estate might also be wiped out. You have to address those issues and you have to make sure that your CEO is aware of them in decisions he makes because a Chapter 7 or a Chapter 11 is going to trigger all personal guarantees which can be very critical to an ongoing successful reorganization of a corporation.

Bankruptcy protection provides the famous automatic stay. Nobody can do anything to us not even the IRS can come levy our accounts. They cannot seize boats, barges or equipment. The bank cannot offset us. There are no law suits. We have got an arena now that we can deal with everybody as a class and it keeps hostile creditors at bay so that we can continue the ongoing operations of the business. When you file bankruptcy, you take a snapshot that fixes the rights and positions of virtually everybody in the proceeding. If I have all of my accounts receivable pledged to the bank, then they get those accounts receivable as of the day of filing. The cash proceeds generated by those accounts receivable belong to the bank. So you have to go work with the bank on the use of what we call "cash collateral". We have got to have a well-prepared, well-thought-out cash flow statement and business plan. You never go into the bank or any institution without a well-thought-out plan on how you are going to solve the problems.

The best thing is that the accounts receivable you generate after filing a Chapter 11 are free and clear because they are not under the bank's lien position. This is "free money." The banks have gotten real smart and clever about that, and they have come back to us and asked us to use this cash collateral on other receivables. What we want is a replacement lien on new receivables we are generating, so we can continue the payroll and the operations of the company. We also get to reject executory contracts. So we can concentrate on those options that make us money and enable us to slim down our operations so we can live within our cash flow budget. We can sell property free and clear of all liens, claims, and incumberances, and investigate fraudulant transfers or preferences that occurred before the Chapter 11 filing.

Reorganization alternatives are numerous, and in todays market and attitude with both debtors and creditors we are coming up with some of the most creative forms of alternatives imaginable. The "cut and run approach" is good but it depends on the health status of the horse we are riding since a cut and run is equivalent to "just let my people out of the trap, we don't want any cheese." Creditors take everything, release my principals and their personal guarantee, and you keep the problem. A lot of times, lending institutions have a company with equipment and an operating company, and the bank has lost faith in the company management. Company management may give the bank the company. The operating company may have a contract to manage it. The bank and operating company will jointly participate in a sale to liquidate and charge a fee for managing the company or give the company the first right of refusal. In other words, let us continue operating just like the original management that proceeded us. The best thing you can do with your lending institution is just cover them with paperwork, but try to read it before you send it to them. And communicate with them. There is absolutely no alternative to communicating. When your lending institution has something positive to say as opposed to something negative it keeps them from getting concerned and nervous.

Equity is something that is going to gain in tremendous popularity and the popular part is give portions of your companies away to your creditors. Let them become your equity holders and partners on the theory that the best person to do business with is yourself. We have had a problem in getting that concept accepted. Some lending institutions will now consider an equity position or an equity kicker along with a restructuring situation. Some lending institutions naturally cannot take that an equity position. Creditors are the same way. If we can peddle our stock to them in leiu of payment, it makes us a much healthier, better company -- even if we have to give them preferred stock with a guaranteed dividend or warrants with the right to convert.

Mortgages in todays market: The magic word is "cash flow mortgage," which is the only mortgage that really works today. It works like this; I will collect all of the money, pay all of the expenses that are approved by the institution, and give the institution everything that is left over, and that will be my payment on what I owe my lending institution(s). This is a basic cash flow mortgage or loaned agreement.

The Chapter 11 is not the institution that it has been. It is a viable tool that you can use to impress management on a company in a controlled situation. It is a tool to get the company to focus on cash flow and budgetary requirements for the company.

WORKOUT STRATEGIES FOR BANK BORROWERS

MARK S. WORTHEN, Texas Commerce Bank

My topic is "Workout strategies for bank borrowers." I will attempt to give you some very practical information that some of you may find useful in dealing with your bank lenders. I will begin with a brief discussion of how banks work, of some of the pressures banks are under and hopefully, to "tip the bank's hand" so you can get a feel for how your problem loan appears from the banker's perspective, and finally provide some basic suggestions for working through problem debt.

Before the creation of the FDIC in the 1930's when a bank failed, the depositors lost a substantial portion, or all of their money deposited in that bank. This fact lead the rational depositor to immediately run to the bank and withdraw all of his or her money at the first sign of trouble. This activity would quickly become a chain reaction and the bank's liquidity would disappear. To make matters worse, the panicked bank would begin demanding payment on its loans and setting the accounts of its borrowers. This led to more business failures, and a vicious cycle that would finally destroy the entire economy as the nation's money supply evaporated.

To break the traditional pattern of runs on banks and to provide the monetary stability on which we all depend today, the federal government created the FDIC to protect depositors from the reckless decisions of bank lenders, and to allow for the orderly liquidation of bank assets to meet the demands of depostiors. A bank's assets are its loans and investments; its liabilities are deposits. Because the federal government guarantees these deposits, it has the mandate to examine the quality of the assets in which these funds are invested. Examiners have traditionally been understaffed and out-gunned by the banks they were charged with regulating. Most of the large bank failures that have made the headlines lately were not even on the "troubled bank" lists of the agencies responsible for overseeing these banks. Needless to say, the bank regulators and Congress have not taken this embarrassment lightly. All of the regulatory agencies, and especially those at the federal level, have upgraded their staffs and are doing a much more effective job examining all facets of bank operations; and especially how a bank deals with its problem credits.

Bank examiners will review all problem credits within a bank above a certain dollar size. They will focus on loans to customers in certain industries such as real estate. The modus operandi is to begin reviewing the information in the bank's file to draw a preliminary conclusion, then interview senior officers of the bank and discuss the credit quality of the subject borrower. The loan will either "pass" the exam or it will be given an adverse grade by the examiners. The bank also will be criticized for any deviations from regulatory policy discovered during the examination. Loans can be and often are adversely graded because of the lack of information in the bank's file. When you get a rush request for financial or other information it is in your best interest to comply with any such request promptly and completely.

When a loan becomes adversely graded, several things happen. First, it immediately impacts the financial condition and profitability of the bank. Banks must subtract from their earnings an allocation for potential loan losses. Another thing that happens is the bank is directed to develop plans for reducing the level of adversely graded loans in the bank. This can mean several actions, including the taking of additional collateral, the addition of personal guarantees, the requirement that personal guarantees be collateralized, asking you to find another bank or simply not renewing the note at the next maturity and demanding payment. A third effect of a loan becoming adversely graded is that the regulatory authorities will examine your loan every time they visit the bank. This increased scrutiny will increase the pressure on your banker to take action on your loan to upgrade its quality or get rid of it. Finally, additional credit accomodations will not be easily available to your company. Banks often do not have any discretion in how they deal with borrowers once they are adversely graded.

Once a credit is identified as a problem, the bank's strategy will be to maximize the net present value of its asset -- that is, your loan, within the legal and regulatory framework in which it finds itself. Stated differently, the bank will seek to recover as much of its interest and principal as possible. When the bank feels that the collection of interest may be in jeopardy, it places the loan on non-accrual and no longer accrues interest on the loan for income purposes. All payments received by the bank are applied to the principal balance on the bank's internal books. The bank's internal accounting is very important as you formulate strategy in working with your bank in a problem situation. When formulating a plan there is no strategy you can develop to work out your problem with the bank that does not involve persuading the bank that your plan will maximize the banks recovery from your loan.

Six suggestions I would submit for your consideration in developing a strategy for a successful workout are:

(1.) Build and maintain credability. Banks can and will do a lot to help you work through a problem, but only if they feel they can rely on you to be open and honest with them. If a debtor is perceived to be dishonest or incompetant or if the bank believes he is misrepresenting or hiding things, the bank would rather not attempt a workout plan even if it means bankruptcy. As a general rule, banks would rather a company not enter bankruptcy because the administrative and legal cost of a bankruptcy runs 30 to 40 percent of the estate of the debtor. However, if a bank believes it is being defrauded by a debtor, it will prefer the control that the bankruptcy court provides, especially if the bank is well secured.

(2.) Take control of the situation. Recent court decisions have strictly curbed the ability of banks to take control and enforce the tough decisions. While this development may seem good to many debtors, an unfortunate side effect has been to cause banks to rule out any kind of workout plan in an out-of-control situation and to simply enforce its remedies. At every crossroads in handling a problem loan, the bank will decide whether to foreclose and demand payment. If the bank sees an out-of-control situation where expenses exceed revenues, working capital is being used to subsidize a net cash drain; or worse, to pay other creditors, since it cannot use its leverage to force needed changes, the bank will pull the plug.

(3.) Develop a genuine financial plan. This financial plan means starting with the revenues actually experienced, then listing a detailed itemized summary of expenses to arrive at the net cash generated by operations. The second half of your financial plan will then allocate this cash among the creditors. Develop contingency plans. Start with your worst case scenario and then do a plan based on a situation twice as bad as that. The most important feature of this plan should be an absolute focus on cash flows. There will be plans where there is sufficient cash to meet principal payments, but only a reduced interest amount. Other cases will be where no principal can be paid, but only a contribution toward interest can be made. If your plan can realistically demonstrate the capability, over time, of repaying a part or all of the dept, it has a chance of being accepted by the bank and the other creditors. It is possible that no plan that can be made will be capable of even covering operating expenses, much less make a contribution to debt service. In this case, the plan will be to liquidate the assets, distribute the proceeds to the creditor and fold the operation. As a rule, you will be able to do a better job and get more money from the assets by selling them yourself, rather than letting the bank repossess the assets and attempt to sell them.

(4.) Include all creditors. Do not expect a bank or any other creditor to make unilateral concessions to make your plan work while other creditors are paid in full. All of your major creditors will have to agree to your plan and be willing to make concessions.

(5.) Implement your plan wisely. After formulating the plan and making it as fair to all creditors as you can make it, meet with them individually to seek their input, their advice, and their consent. After the plan is in place, you should be in continual contact with all creditors. At this stage, timely information will keep the workout alive. Financial statement and information should be prepared and distributed monthly, and in some cases, weekly. If the performance is below projections, make the necessary adjustments to make it conform to the plan. If this is not possible, then take agressive action to again meet with your creditors to adopt your contingency plan.

(6.) Attempt lump sum settlements. As a part of your workout plan, you will probably include the sale of certain assets that will produce lump sums of cash. If you can get the other creditors permission, you may be able to settle certain debts for a fraction of the face amount by offering cash settlements.

In conclusion, the most important concept that governs workout situations is economics. This is not the place for emotions, accusations or recriminations. Each party to a workout plan must constantly answer the question, "Am I better off going along with this plan, or should I exercise my remedies?" The task in developing a successful workout plan is to make the answer to that question "yes" for all involved parties.